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"The Market as Interpreted under the Dow Theory"

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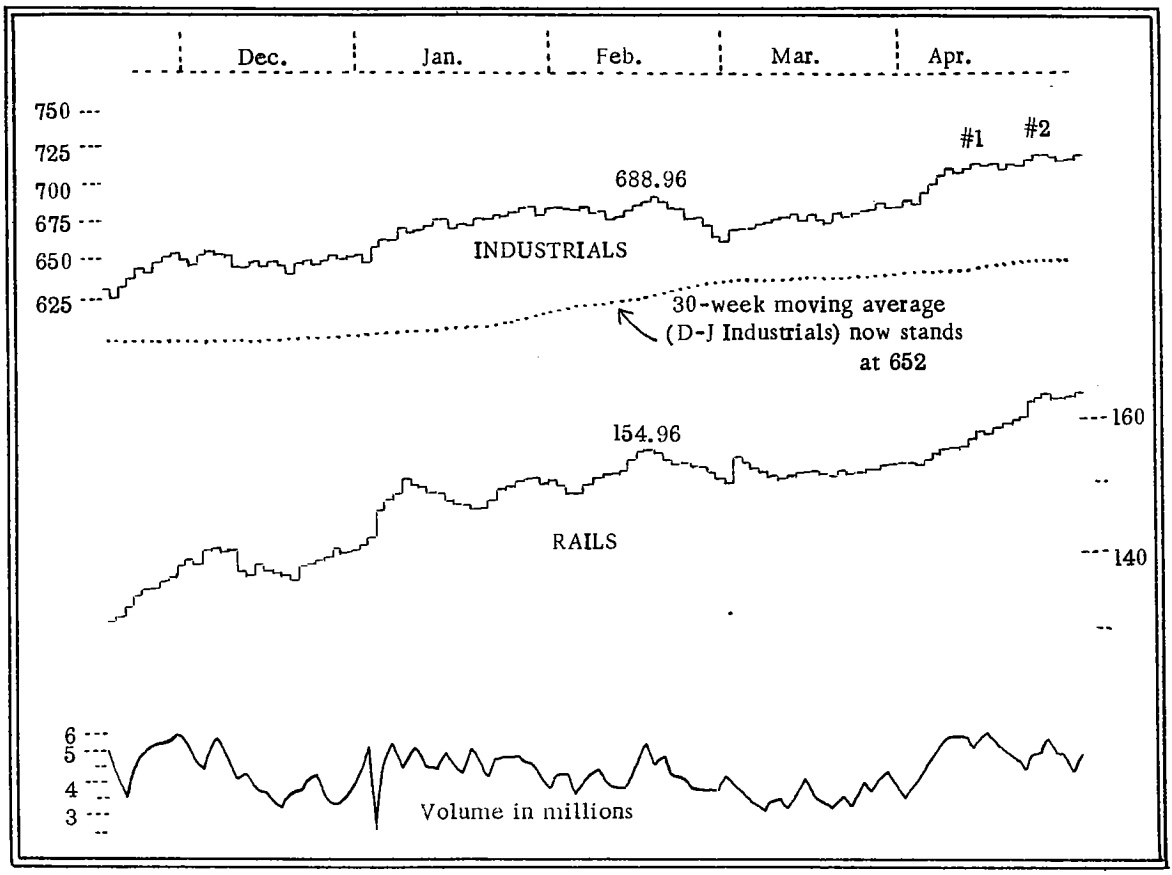
THE MARKET Industrials have pushed up to within 2% of their 1961 all-time high (734.91), while Rails have climbed to within 10 points of their 1959 peak of 173.56. Despite this, interest seems to remain at a low ebb, with speculation notably absent, and most former boardroom habituees evidently tending to their chosen professions. It reminds one of an Olympic dash champion about to break a world's record while the "spectators" in the stands are sleeping or playing gin rummy with their neighbors.

The advance-decline ratio on the N.Y.S.E. has been sluggish but nevertheless it has moved into new recovery high ground, thereby confirming Industrials. Strangely (and this could be significant) the A-D ratio on the American has broken down, dropping to the lowest level since last January (see chart in Letter 216, page 2). Thus the speculative and lesser-quality sector of the market has gathered little or no following from the professionals or the public.

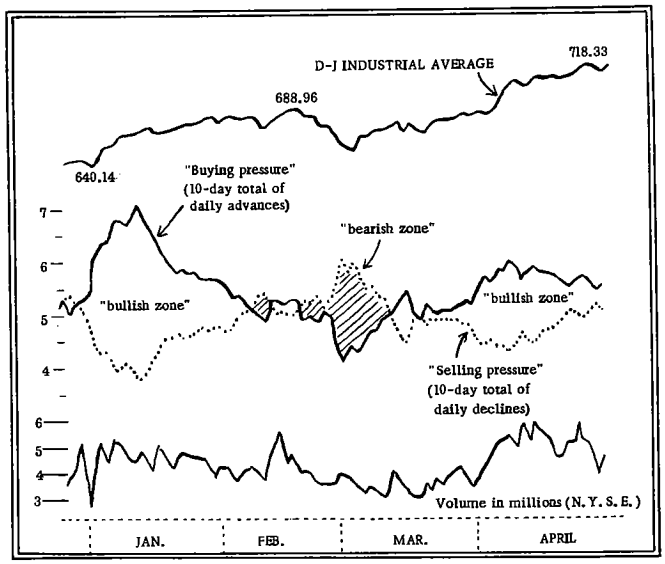
Volume expanded tremendously during most of April, and this phenomenon was commented upon in the last letter. It may be significant that the first thrust toward the all-time high (which I have labeled #1 on the chart) brought in volume of almost 6 million shares per day. The second thrust (#2) brought in noticeably less volume. If a new assault on the high is to be successful, it seems to me that it will take volume in the 6 million and above class to move Industrials over their 734.91 all-time peak. On the other hand, if a new thrust fizzels on volume of say 3 to 4 million shares, it would pay us to be on guard. Diminishing volume on successive rallies is a distinctly negative phenomenon.

BUYING AND SELLING PRESSURE The buying line has now held above the selling line for 35 consecutive days (see comments in Letter 216). The peak of buying strength and the low of selling pressure were registered in early April (see chart), and the two lines have been drawing together since that time. Nevertheless, they have not yet crossed to a bearish position.



The buying line is refusing to rise to new highs (above its April high) despite the fact that the Industrial Average is recording new recovery highs. For this reason, we can say that the broad market is showing a good deal of upside "resistance". However, I believe that time is running out on the possibility of a crossing of the lines and resultant "trouble". It seems to me that if there is to be a bearish crossing (selling line above buying), it should occur in the next 5 or 10 days. On

the other hand, if the buying line rises from here and the selling line recedes, the stage will be set for an important (and perhaps explosive) extension of the rise.



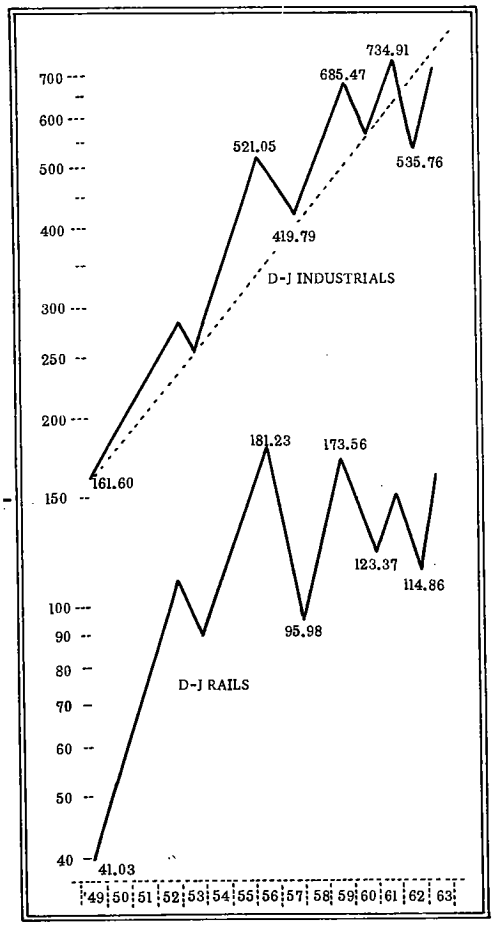
BIG PICTURE The accompanying logarithmic chart traces the major swings of the D-J Averages since 1949. As discussed many times in these Letters, logarithmic (sometimes called ratio) scale shows percentage of increase or decrease. Thus it becomes readily apparent, for instance, that the giant Rail rise of 1949 (41.03) to 1953 (112.43) was the most profitable movement to appear in either of the D-J Averages since 1949. That rise amounted to 173% for Rails, a percentage move that has not been approached since.

The great ascending trendline of 1949-62 (Industrial Average) has been commented upon before in these Letters. As seen on the chart, the senior Average is now approaching the underside of this historic trendline. Personally (and based on my own experience with such phenomena) I do not think Industrials will rise above the trendline. This does not preclude a new all-time high for the Senior Average, however.

The Rails are now approaching the vicinity of their July, 1959 peak of 173.56. Yet note the recent erratic action of Rails. In 1962 the carrier Average broke below its 1960 low of 123.37. Ordinarily (as with Industrials in 1962) this would have implied a strong continuation of the downward trend. But after reversing in October, 1962, Rails have most recently risen above their 1961 peak of 152.92. This leaves only two critical Rail levels ahead, the 173.56 peak of 1959 and the 181.23 high of 1956.

"What do we have", a subscriber asked last week, "if the Rails go through their 181.23 high and Industrials hurdle their 734.91 all-time high?" One thing we'll have if both Averages go to new highs, I told him, will be a lot of "re-thinking" to do. But first, it has to happen.

AFTERMATH OF THE "LINE" Letter 213 drew attention to the long, sideways movement of the market, and at that time I stated that I believed the two Averages had formed a line. On April 3, the Industrials pushed above the upper limits of the line (see Letter 215), and on April 5 the Rails confirmed by hurdling their own upper line limits. Since April 5 Industrials have tacked on 25 points while Rails have added 10.



I have received many letters over the past month asking for more information regarding the significance of the breaking of the 1963 line. Following are a few thoughts and quotes which I believe are applicable:

The recent line extended from early January to early April, 1963. During that period average daily volume ran unusually high -- 4.1 million shares per day (although volume usually contracts noticeably within a line area). Commenting on the subject of volume and lines, Robert Rhea wrote (1934): "It has been noticed that the tendency of 'lines' is to broaden near peaks of bull markets, as does the volume of trading. On the other hand, lines forming near the bottoms, or in very dull periods, are correspondingly narrow."

A further comment from Rhea regarding lines: "Hamilton always seems to have used the words 'accumulation' and 'distribution' in the normal sense; nevertheless, I have often wished that he had gone further in his classification and differentiated between wise and unwise accumulation and distribution. He often did this by implication, but it would be taking liberties with a classical theory if any of us less experienced observers attempted to inject new phraseology or ideas into the picture.

"At the risk of being accused of tampering with the theory, I submit the following for the consideration of serious students: In 1929 a 'line' was broken topside shortly before the peak of the great bull market was reached. True, the advance carried along for

several weeks after penetration. When the line was being formed, activity was averaging eight times as much as at the beginning of the rise in 1923, and the formation occurred after an excited advance. Considering activity, the duration and extent of the advance and all other known factors, would we not have been justified in taking the buying to have been 'unwise accumulation'? Subsequent events proved that those who bought then were worse than unwise. They were downright foolish. Many similar situations can be found in the record of the Averages."

The above quotes are included in view of the fact that the 1963 line came following a sharp advance, and because average Industrial yields are currently at the low (i.e., "overvalued") end of the scale. I want readers to understand that there is a difference between a long line breaking upside following what seems like the completion of a bear market, and a long line breaking up (following an extended advance) in what seems like an area of overevaluation.

COMMENTS AND LETTERS I seldom write a paragraph (much less a full page) which does not result in a letter of comment or disagreement from a subscriber. Many of these correspondents are highly intelligent, and frequently views are expressed which are in direct disagreement with my own. The following letter was received last week, and it represents an important line of reasoning: "Everyone seems to be commenting on the strange behavior of the odd-lots, so I will add some thoughts of my own. This heavy odd-lot selling is symptomatic of the huge overhead supply (probably the greatest supply in history) between 680 and 740. Despite the apparent contradiction between odd-lot trading and the monthly selling balances, I believe that the round-lot public is selling just as hard as the odd-lotter. The great increase in time and demand deposits says so.

"The ability of the market to advance against this heavy supply is to my mind nothing short of phenomenal. The market is chewing up this overhead supply without apparently anybody realizing what is going on. The ability of the market to continue to rise indicates to me that very important and intelligent money is coming in, money that will not scare out on setbacks. This heavy selling also represents a further liquidation of the excesses that were not completely washed away in the crash of last spring. When this selling stops, there will be enough momentum of buying power to propel the Averages 40 points in a flash, but where the selling will stop is still unknown." (C. W. Yakima, Washington).

PERSONAL THOUGHTS The writer remembers reading advertisements in the financial section of the New York newspapers during the 1940's, advertisements which ran roughly as follows: "Why keep your money in the Savings Bank at 2 1/2% interest when top-grade Oil Stocks will pay you up to 10%?" It occurred to me at the time that good stocks were literally "going begging". During the early and late 1940's the public was convinced that dollars were the most valuable thing around, and that ownership of common stocks represented an absurd and unnecessary risk. The following, in fact, is quoted from Garfield Drew's outstanding book, "New Methods for Profits in the Stock Market" (the book was originally published in 1941 and this paragraph is from the first edition): "During the past year the author has been asked by many well-meaning friends why he should publish a book on stock market profits at a time when 'there are no profits'; when the financial business is supposed to be just waiting for the knockout punch; when the public is apathetic even to good stocks yielding 7 or 8%; when there is visualized nothing ahead but a long vista of more tightly controlled economy that will choke off all free enterprise, and with it the Stock Exchange which is the nerve center of the whole system."

During the 1940's Wall Street was not really considered a "bad word" among college students; it simply was not considered at all. I remember that "advertising" was the college graduate's dream during the 1940's -- while going to Wall Street was considered tantamount to "a one-way ticket to oblivion".

Many things have changed in the past 15 to 20 years. Today Wall Street has status. A bank is no longer a place to keep one's savings; it is a place to borrow money. Today average stock yields have diminished to the low 3% zone, while average corporate bond yields are in the 4.5% zone. Savings institutions now provide dividends and interest of 4 to 4.8%, and the average American considers it "smart" to own as little equity as possible in his house, his car or his freezer.

As a rule, the longer the loan, the riskier the debt, but much of today's loans are being placed on a very long-term basis. A few days ago the Wall Street Journal (April 18, page 1) saw fit to issue a warning regarding three-year and even four-year auto loans (some with as little as 5% down) and 25 and 30-year mortgages (some with only 5% down). Thus people are willing to buy now with nothing down on the chance of being able to pay back with tomorrow's "cheap" dollars.

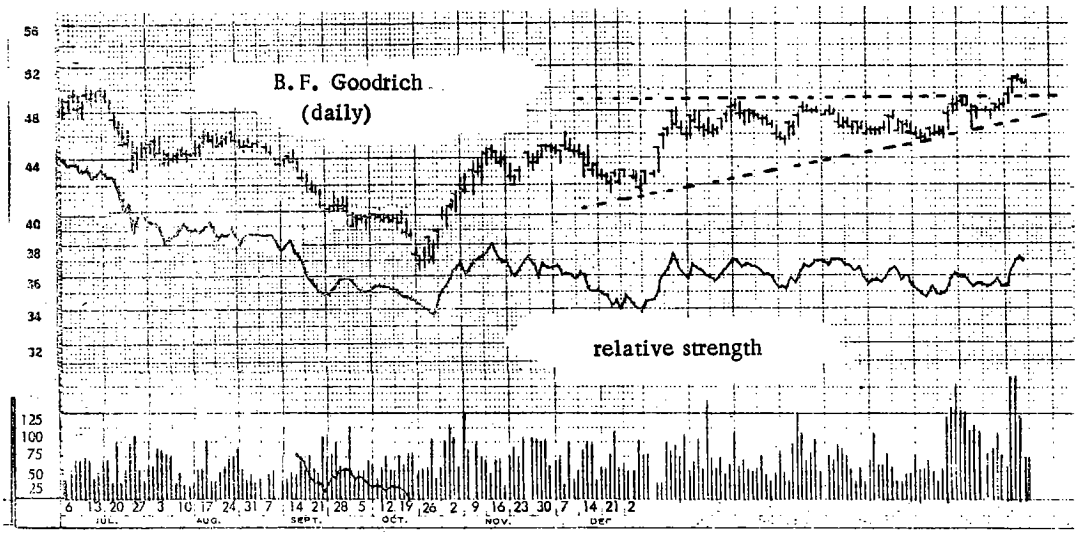
U. S. News and World Report (April 29) reports that "warning signs" are beginning to show up in the form of "rising home foreclosures and soaring bankruptcies." Personal debt, they note, has risen 54% since 1957, while the number of personal bankruptcies has doubled in the last five years "... and has now climbed to somewhere between 500 and 600 a day."

It seems to me that just as stocks were basically undervalued and "asking to be bought" during the 1940's, so today money is undervalued and "asking to be put away." This is not meant to imply that over the next month or so deflation will suddenly bring dollars back into their own or that more monetary inflation will not take place. Actually, many months could pass before anything occurred which might serve to undermine the value of stocks and tangible "things" -- and thus enhance the value of hard dollars. But I feel that from the standpoint of history, we will look back to the early 1960's as a time when dollars were "easy to get" at a time when "nobody really wanted them".

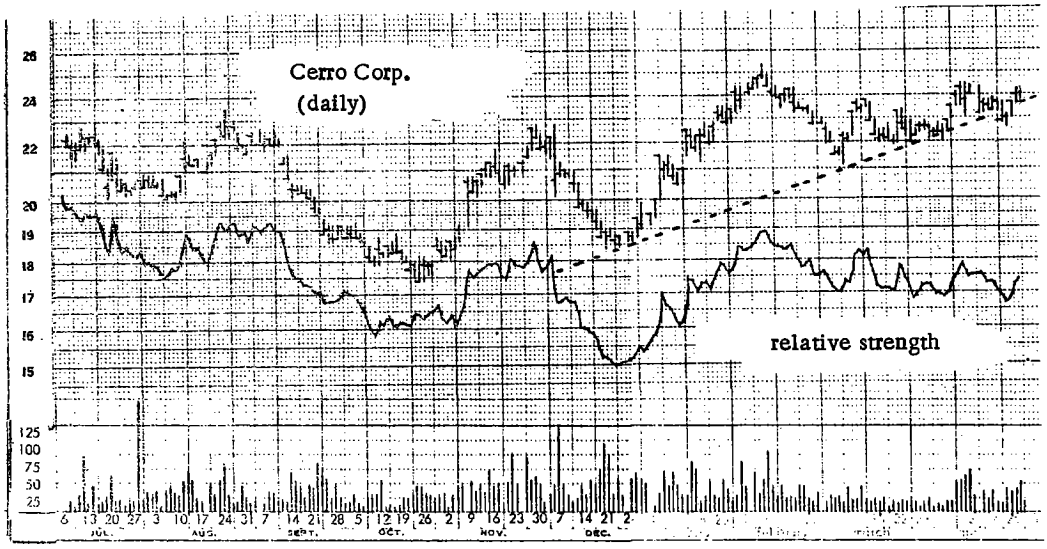
LATE NOTES As of May 1, Industrials, Rails and the advance-decline ratio closed at new 1963 recovery highs. This has been the signal for a continuation of the rise whenever it has occurred since June, 1962.

STOCKS Of 350 representative stocks which are tabulated weekly at this office, 251 or 72% are holding above their moving average.

Autos, Airlines and Oils show the best group relative strength while Aircraft and Motion pictures show marked weakness. Groups turning stronger are Electrical Equipment (G.E., Westinghouse) and Drugs (Amer. Home Products, Merck, Pfizer).

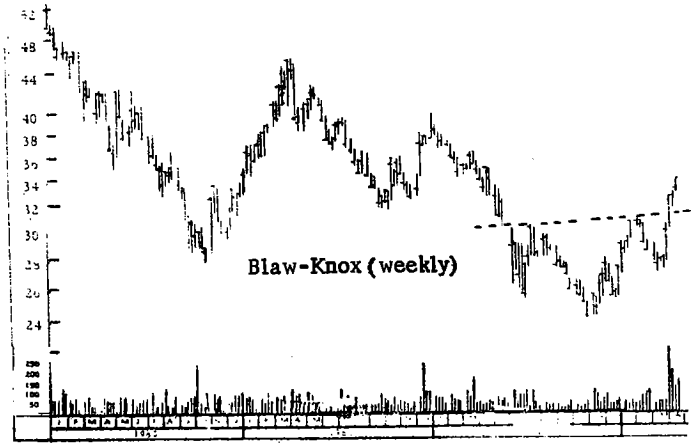


Shown below are two daily charts which appear particularly interesting at this point. B. F. Goodrich, a high-quality stock in the laggard rubber group, has bettered the 49-peak area, and we may assume that all the stock below 49 has now been absorbed. Volume in Goodrich has expanded noticeably as the stock moved above 50. Goodrich should be a "buy" at the market.



Cerro Corp., mentioned in Letter 203, has been moving generally higher since October, 1962. It is a low-priced speculative stock, and one that would seem to offer more upside potential than most. I still classify Cerro as a speculative purchase, but it might be bought again on a "clean breakout" of 26 or better.

Another speculative issue, Blaw-Knox has broken out of a very large reverse head-and-shoulders pattern. This issue has been in a downtrend since its 1959 high of 56. Its 1962-63 base is large enough to pass for a major reversal.



Charts on this page courtesy of Traders Research, P.O. Box 2466, St. Louis 16, Missouri.